RESERVE BANK OF INDIA AND THE FOREIGN EXCHANGE MARKET IN INDIA

CA. Nidhi Jain

nidhijain@vinodkothari.com

Vinod Kothari Consultants P Ltd.

Kolkata Office:
1012, Krishna
224, AJC Bose Road
Kolkata 700 017
Ph: 2281 7715

Mumbai Office
222, Ashoka Shopping Centre
2nd, Floor, LT Road
Near GT Hospital
Mumbai – 400 001

THE RESERVE BANK

- The Reserve Bank of India (RBI) is *Nation's Central Bank.*
- RBI began its operations in the year 1935.
- The year *1949* earmarked the enactment of Banking Regulation Act, 1949 and the *nationalization of Reserve Bank of India*.
- RBI stands at the centre of Indian Financial System with the fundamental objective of *ensuring monetary and financial stability in the country.*

WHAT RBI DOES??

- Formulation and implementation of Monetary Policy.
- Supervision of financial system.
- Issue of Currencies.
- Management of Foreign Exchange reserves
- Banking and Debt Management Services to the Government.

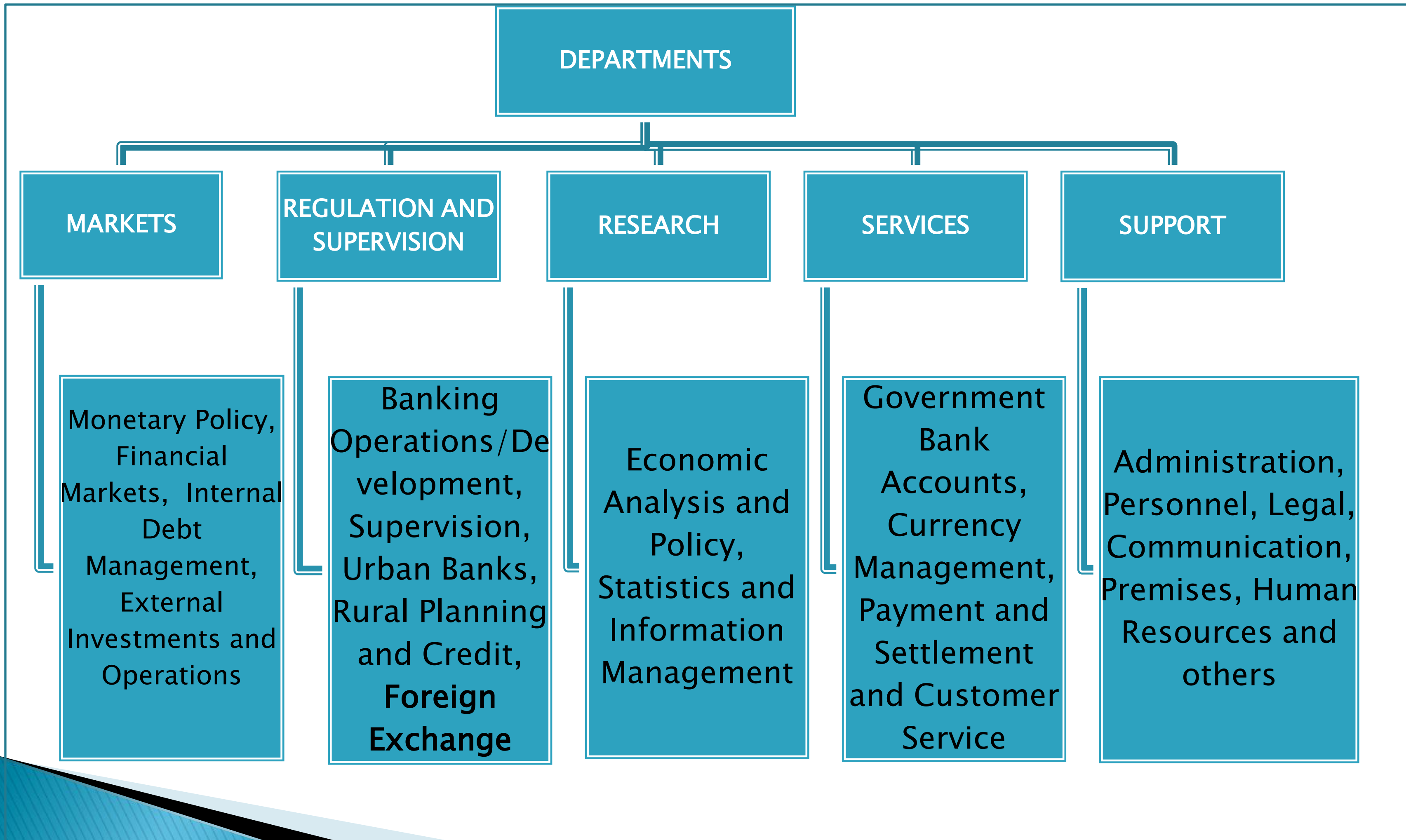
WHAT RBI DOES??

- Supervise the payment system
- Act as banker to banks
- Perform Developmental functions
- Conduct Research and Share Data and Knowledge

ORGANISATIONAL SET-UP

- RBI is wholly owned by the Government of India.
- Business is overseen by the Central Board.
- Special Functions of the Central Board delegated to Committees and Sub-committees.
- Management team includes:
  - Governor: the Chief Executive
  - Deputy Governors
  - Executive Directors.
  - Various Departments

ORGANISATIONAL SET-UP



FOREIGN EXCHANGE DEPARTMENT OF RBI

FOREIGN EXCHANGE (FOREX) DEPARTMENT OF RBI

- Foreign Exchange Department lays down policies and procedures under FEMA.
- The Central Office is situated in Mumbai.
- The Department has 17 Regional Offices and 2 cells.

SIGNIFICANCE OF FOREIGN EXCHANGE DEPARTMENT

- To facilitate external trade and payments and promote orderly development and maintenance of foreign exchange market in India.
- To facilitate smooth cross-border transactions.
- To collect data on a real time basis in order to inflict policy changes in a dynamic way.
- To have regular interface with the users to assess their needs with greater focus on the requirements of resident individuals / entities.

FUNCTIONS OF FOREX DEPARTMENT

Conduct of Forex Transactions

Considers applications requiring approval of RBI under FEM (Current Account Transactions) Rules, 2000 and (Capital Account Transactions) Regulations. Authorised Persons have been delegated the power to meet the foreign exchange needs of Persons Resident in India. Resident Individuals can make permissible capital and current account transactions under Liberalised Remittance Scheme.

FUNCTIONS OF FOREX DEPARTMENT

Compounding Authority for Contraventions

RBI has been vested with the power to compound the contraventions of all the Sections of FEMA, 1999. All applications for compounding are to be submitted to Foreign Exchange Department. *Recently, the power has been delegated to various Regional Offices of RBI.*

FUNCTIONS OF FOREX DEPARTMENT

Collection of Data

The Department collects data relating to foreign exchange transactions from authorised dealers on a daily basis for exchange rate management and on a fortnightly basis for monthly quick estimates of balance of payments and quarterly balance of payments compilation.

FUNCTIONS OF FOREX DEPARTMENT

Framing Risk Management Guidelines

The Department lays down policy guidelines for risk management relating to foreign exchange transactions in banks.

FUNCTIONS OF FOREX DEPARTMENT

Review and Simplification of Procedures

With a view of further improving facilities available to NRIs and removing irritants, the Department is also engaged, on an ongoing basis, in reviewing and simplifying the procedures and rules.

FUNCTIONS OF FOREX DEPARTMENT

LICENSING AUTHORITY

The Department is also entrusted with the responsibility of licensing banks/money changers to deal in foreign exchange and inspecting them.

FOREIGN EXCHANGE MARKET - THE INDIAN SCENARIO

BASICS OF FOREIGN EXCHANGE MARKET

- The market in which currencies are traded is called the foreign exchange market or more popularly, *forex market*.
- Currency Trading is the world's largest as well as most liquid market. Forex markets are believed to be the most efficient financial markets.
- Foreign exchange market is not a single exchange, but is constructed of a global network of computers that connects participants from all parts of the world.
- Foreign exchange markets are made up of banks, commercial companies, central banks, investment management firms, hedge funds, and retail forex brokers and investors.

BASICS OF FOREIGN EXCHANGE MARKET

- Trades involve the buying of one currency and the selling of another currency simultaneously because the value of one currency is determined by its comparison to another currency.

- Currency pairs can be thought of as a single unit that can be bought or sold. The first currency of a currency pair is called the "base currency," while the second currency is called the counter currency. The currency pair shows how much of the counter currency is needed to purchase one unit of the base currency. When purchasing a currency pair, the base currency is being bought, while the counter currency is being sold. The opposite is true, when the sale of a currency pair takes place.

FOREIGN EXCHANGE MARKET IN INDIA- FLASHBACK

- During the period from 1947 to 1971, India followed the par value system of exchange rate. Initially the rupee's external par value was fixed at 4.15 grains of fine gold. The Reserve Bank maintained the par value of the rupee within the permitted margin of ±1 per cent using pound sterling as the intervention currency. Since the sterling-dollar exchange rate was kept stable by the US monetary authority, the exchange rates of rupee in terms of gold as well as the dollar and other currencies were indirectly kept stable. Therefore, the foreign exchange market for all practical purposes was defunct.

FOREIGN EXCHANGE MARKET IN INDIA- FLASHBACK

- In terms of the provisions of FERA, the Reserve Bank, and in certain cases, the Central Government controlled and regulated the dealings in foreign exchange payments outside India, export and import of currency notes and bullion, transfers of securities between residents and non-residents, acquisition of foreign securities, etc.

- In December 1971, the rupee was linked with pound sterling. Since sterling was fixed in terms of US dollar under the Smithsonian Agreement of 1971, the rupee also remained stable against dollar.

FOREIGN EXCHANGE MARKET IN INDIA- FLASHBACK

- In order to overcome the weaknesses associated with a single currency peg and to ensure stability of the exchange rate, the rupee, with effect from September 1975, was pegged to a basket of currencies. The currency selection and weights assigned were left to the discretion of the Reserve Bank.

- In 1978, banks in India were allowed by the Reserve Bank to undertake intra-day trading in foreign exchange which gave an impetus to trading in the foreign exchange market in India.

FOREIGN EXCHANGE MARKET IN INDIA- FLASHBACK

- Till the early 1990s, the market, however, remained highly regulated with restrictions on external transactions, barriers to entry, low liquidity and high transaction costs.
- The exchange rate during this period was managed mainly for facilitating India's imports.

FOREIGN EXCHANGE MARKET IN INDIA- FLASHBACK

- The strict control on foreign exchange transactions through the Foreign Exchange Regulations Act (FERA) had resulted in one of the largest and most efficient parallel markets for foreign exchange in the world, *i.e., the hawala* (unofficial) market.

- Wide ranging reform measures were adopted in the year 1992 and onwards, aimed at widening and deepening the foreign exchange market and liberalisation of exchange control regimes.

FOREIGN EXCHANGE MARKET IN INDIA- FLASHBACK

- A unified exchange rate system was adopted in March 1993, whereby all foreign exchange receipts could be converted at market determined exchange rates.
- **The unification of the exchange rate of the Indian rupee was an important step towards current account convertibility, which was finally achieved in August 1994**
- With the rupee becoming fully convertible on all current account transactions, the risk-bearing capacity of banks increased and foreign exchange trading volumes started rising.

FOREIGN EXCHANGE MARKET IN INDIA- FLASHBACK

- Several initiatives aimed at dismantling controls and providing an enabling environment to all entities engaged in foreign exchange transactions have been undertaken since the mid-1990s. The focus has been on developing the institutional framework and increasing the instruments for effective functioning, enhancing transparency and liberalising the conduct of foreign exchange business.

THE INITIATIVES UNDERTAKEN

1

- The Foreign Exchange Regulation Act (FERA), 1973 was replaced by the market friendly Foreign Exchange Management Act (FEMA), 1999.

2

- The Reserve Bank delegated powers to authorised dealers (ADs) to release foreign exchange for a variety of purposes.

3

- The Clearing Corporation of India Limited (CCIL) was set up in 2001.

THE INITIATIVES UNDERTAKEN

4

- The rupee-foreign currency swap market was allowed.

5

- Additional hedging instruments such as foreign currency-rupee options, cross-currency options, interest rate swaps (IRS) and currency swaps, caps/collars and forward rate agreements (FRAs) were introduced.

6

- Authorised dealers were permitted to initiate trading positions, borrow and invest in overseas market, subject to certain specifications.

THE INITIATIVES UNDERTAKEN

7

- Participants in the foreign exchange market, including exporters, Indians investing abroad, and FIIs were permitted to avail forward cover and enter into swap transactions without any limit, subject to genuine underlying exposure.

8

- FIIs and NRIs were permitted to trade in exchange traded derivative contracts, subject to certain conditions.

THE INITIATIVES UNDERTAKEN

9

- Foreign exchange earners were permitted to maintain foreign currency accounts. Residents were permitted to open such accounts within the laid down general limit.

10

- The Reserve Bank disseminates: daily reference rate, data on exchange rates of rupee against some major currencies and foreign exchange reserves and data on purchases and sales of foreign currency.

REGULATION AND MANAGEMENT OF FOREIGN EXCHANGE

- Foreign Exchange Regulation Act (FERA), was the primary enactment for the regulation of foreign exchange.
- Objective of FERA was to conserve foreign exchange and utilise the same for the economic development of the country.
- Foreign Exchange Management Act, 1999 (FEMA) replaced FERA in the year 2000.
- Objective of FEMA is to facilitate external trade and payments and promote orderly development and maintenance of foreign exchange market in India.

FEATURES OF INDIAN FOREX MARKET

- Decentralised multiple dealership market comprising **two segments** – the spot and the derivatives market.
- In the spot market, currencies are traded at the prevailing rates.
- The derivatives market encompasses forwards, swaps and options.
- Players in the Indian market include – (a) ADs, mostly banks who are authorised to deal in foreign exchange, (b) foreign exchange brokers who act as intermediaries, and (c) customers.

FEATURES OF INDIAN FOREX MARKET

- Though customers are major players in the foreign exchange market, for all practical purposes they depend upon ADs and brokers.
- The Reserve Bank undertakes sales/purchases of foreign currency in periods of excess demand/supply in the market.
- Foreign Exchange Dealers' Association of India (FEDAI) plays a special role in the foreign exchange market for ensuring smooth and speedy growth of the foreign exchange market in all its aspects.
- **All ADs are required to become members of the FEDAI**
- The FEDAI is also the **accrediting authority** for the foreign exchange brokers in the interbank foreign exchange market.

FEATURES OF INDIAN FOREX MARKET

- The licences for ADs are issued to banks and other institutions, on their request, under Section 10(1) of the Foreign Exchange Management Act, 1999.
- The customer segment of the foreign exchange market comprises major public sector units, corporates and business entities with foreign exchange exposure.

FEATURES OF INDIAN FOREX MARKET

- Sources of Supply of foreign Exchange

In the Current Account

Receipts on account of exports and services

In the Capital Account

Foreign Direct Investment (FDI), Portfolio Investment, External Commercial Borrowings (ECB) and Non-Resident Deposits Receipts on account of exports and services

FEATURES OF INDIAN FOREX MARKET

- Sources of Demand of Foreign Exchange

In the Current Account

Imports and services payments

In the Capital Account

Amortisation of ECB (including short-term trade credits) and external aid, redemption of NRI deposits and outflows on account of direct and portfolio investment

FOREX DERIVATIVE MARKET IN INDIA

- Derivatives enable market players to hedge against underlying exposures and shape the overall risk profile of participants in the market and thus play a crucial role in developing the foreign exchange market, keeping in view the liquidity and volatility in this market.

- Cross-currency derivatives with Rupee as one leg were introduced in April, 1997 with some restrictions.

FOREX DERIVATIVE MARKET IN INDIA

- Rupee-foreign exchange options were allowed in July 2003.
- The foreign exchange derivative products that are available in Indian financial markets can be grouped into three broad segments:

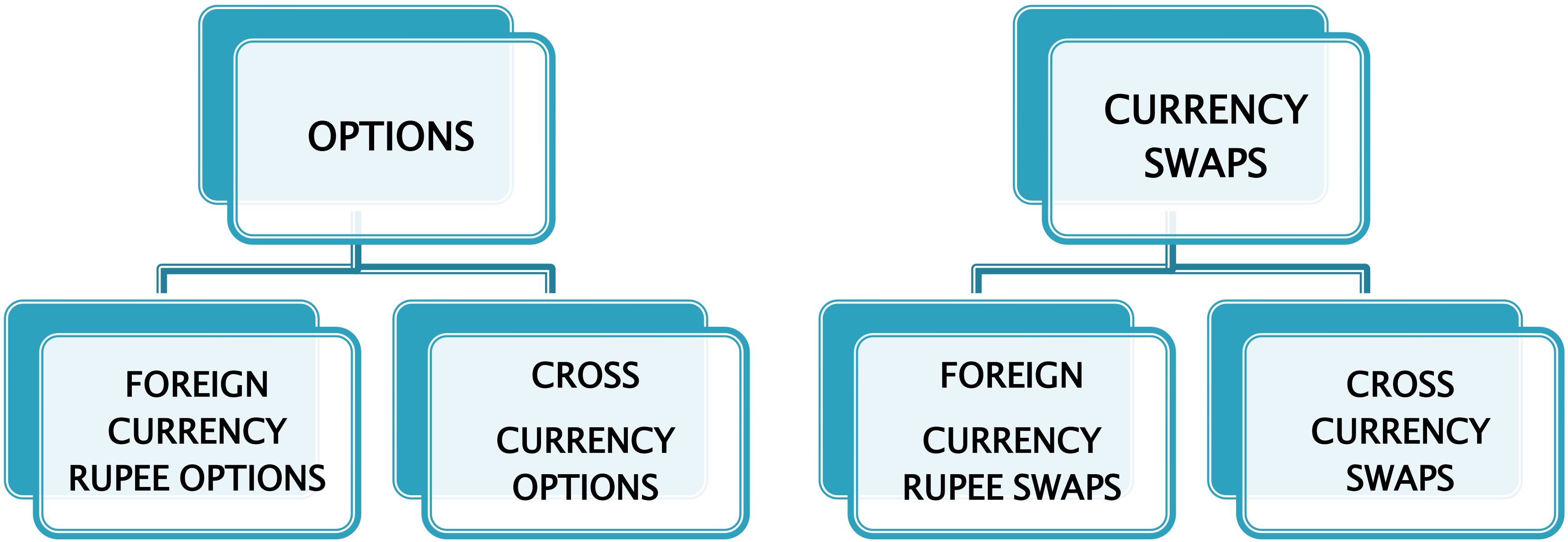
FORWARDS

OPTIONS

CURRENCY SWAPS

FOREX DERIVATIVE MARKET IN INDIA

- The Sub-segments are:



FOREX DERIVATIVE MARKET IN INDIA

- In the forward segment of the Indian foreign exchange market, trading takes place both *over the counter (OTC) and in an exchange traded market* with brokers playing an important role.

- A foreign exchange forward contract is an agreement to buy a certain amount of a foreign currency against another currency (in our context, Rupee, the domestic currency) at a rate fixed at the time of entering into the contract. It is used to hedge against the exchange risk arising out of a

FOREX DERIVATIVE MARKET IN INDIA

future exposure, for example, export proceeds, import payments, debt servicing or repayment, etc.

- A currency futures is a contract in which parties agree to exchange cash flows in two different currencies at an agreed upon date in future.

FOREX DERIVATIVE MARKET IN INDIA

- A currency option is a contract that gives the buyer the right , but not the obligation, to exchange one currency for another at a pre-determined rate of exchange on or until the maturity date.
- When currency futures or currency options are traded on the exchanges, these become exchange traded currency F&O contracts or else these are Over-the-Counter (OTC) F&O contracts.

RBI'S COMPREHENSIVE GUIDELINES ON FOREIGN EXCHANGE DERIVATIVES

- Cover broad generic principles for undertaking derivative transactions, permissible categories of derivative instruments, defining the role of market makers and users, suitability and appropriateness policies, risk management and corporate governance aspects, and internal control and audit.

- For risk management and corporate governance related to banks' exposure to derivatives markets, basic principles of a prudent system have been specified.

RBI'S COMPREHENSIVE GUIDELINES ON FOREIGN EXCHANGE DERIVATIVES

- Basic Principles entail:

Appropriate oversight by the board of directors and Senior management

Comprehensive internal controls and audit procedures

Adequate risk management process that integrates prudent risk limits, sound measurement procedures and information systems, continuous risk monitoring and frequent management reporting

RBI'S COMPREHENSIVE GUIDELINES ON FOREIGN EXCHANGE DERIVATIVES

- Regarding risk management, the guidelines explain identification and accurate measurement of various types of risks, by the market makers, involved in derivative activities.

- The guidelines also lay down various risk limits, *viz.*, market risk limits, credit limits, and liquidity limits, which serve as a means to control exposures to various risks associated with derivative activities.

RBI'S COMPREHENSIVE GUIDELINES ON FOREIGN EXCHANGE DERIVATIVES

- The guidelines also include the requirement of a mechanism for an independent monitoring of each entity and controlling of various risks in derivatives.

- The guidelines cover details pertaining to internal audit, prudential norms relating to derivatives, prudential limits on derivatives, and regulatory reporting and balance sheet disclosures.

FOREIGN EXCHANGE MANAGEMENT ACT – AN OVERVIEW

AN OVERVIEW OF FEMA

- FEMA categorizes foreign exchange transactions into:

Capital Account Transactions [Section 2(e)]

- Transactions that alter the assets or liabilities, including contingent liabilities outside India, of persons resident in India or assets or liabilities in India of persons resident outside India

Current Account Transactions [Section 2(j)]

- Transactions that are not Capital Account Transactions.

CURRENT ACCOUNT TRANSACTIONS

- Foreign Exchange Management (Current Account Transactions) Rules, 2000 notified by the Government of India governs Current Account Transactions.

- Three categories of current account transactions listed down under the rules:
  - Prohibited transactions.
  - Transactions requiring prior approval of Government of India.
  - Transactions requiring prior permission from the Reserve Bank of India.

CURRENT ACCOUNT TRANSACTIONS

- Delegation of powers has been made to Authorised Persons to allow current account remittances for operational convenience.

- Classification of APs has been made as under:
  - Category – I: ADs which include banks.
  - Category – II: ADs which include upgraded Full Fledged Money Changers (FFMCs), Co-operative Banks, Regional Rural Banks (RRBs) and other entities
  - Category – III: ADs which include select financial and other institutions

- Persons resident in India can avail of various facilities made available to them under the FEMA from the Authorised Persons who, thus, become an interface between the RBI and the common person.

FOREIGN EXCHANGE MANAGEMENT (CURRENT ACCOUNT TRANSACTIONS) RULES, 2000

- Drawal of foreign exchange by any person for the following purpose is prohibited:
- Remittance out of lottery winnings.
- Remittance of income from racing/riding, etc., or any other hobby.
- Remittance for purchase of lottery tickets, banned/prescribed magazines, football pools, sweepstakes etc.
- Payment of commission on exports made towards equity investment in Joint Ventures/Wholly Owned Subsidiaries abroad of Indian companies.
- Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
- Payment of commission on exports under Rupee State Credit Route, except commission up to 10% of invoice value of exports of tea and tobacco
- Payment related to "Call Back Services" of telephones.
- Remittance of interest income on funds held in Non-resident Special Rupee Scheme a/c.

FOREIGN EXCHANGE MANAGEMENT (CURRENT ACCOUNT TRANSACTIONS) RULES, 2000

- No person is allowed to draw foreign exchange for a transaction included in the Schedule II to the Rules, e.g., cultural tours, Multi-modal transport operators making remittance to their agents abroad, etc. without **prior approval of the Government of India except** where the payment is made out of funds held in Resident Foreign Currency (RFC) Account of the remitter.
- No person shall draw foreign exchange for a transaction included in the Schedule III to the Rules, e.g., one or more private visits to any country in a calendar year, gift remittance, donations, maintenance of close relatives abroad, etc. exceeding specified limits without prior approval of the RBI **except** where the payment is made out of funds held in Resident Foreign Currency (RFC) Account of the remitter.

FOREIGN EXCHANGE MANAGEMENT (CURRENT ACCOUNT TRANSACTIONS) RULES, 2000

- The items specified in Schedule III are:
  - Release of exchange exceeding [US $ 10,000] or its equivalent in one calendar year, for one or more private visits to any country (except Nepal and Bhutan).
  - Gift remittance exceeding US $ 5,000 per remitter/donor per annum.
  - Donation exceeding US $ 5,000 per remitter/donor per annum.
  - Exchange facilities exceeding US $ 100,000 for persons going abroad for employment.
  - Exchange facilities for emigration exceeding US $ 100,000 or amount prescribed by country of emigration.

FOREIGN EXCHANGE MANAGEMENT (CURRENT ACCOUNT TRANSACTIONS) RULES, 2000

- Remittance for maintenance of close relatives abroad, exceeding net salary (after deduction of taxes, contribution to provident fund and other deductions) of a person who is resident but not permanently resident in India and is a citizen of a Foreign State other than Pakistan; or is a citizen of India, who is on deputation to the office or branch or subsidiary or joint venture in India of such foreign company.
- Remittance for maintenance of close relatives abroad exceeding US$ 100,000 per year per recipient, in all other cases.
- Release of exchange for **studies abroad** exceeding the estimates from the institution abroad or US $ 100,000 per academic year, whichever is higher.

FOREIGN EXCHANGE MANAGEMENT (CURRENT ACCOUNT TRANSACTIONS) RULES, 2000

- Release of foreign exchange, exceeding US $ 25,000 to a person, irrespective of period of stay, for business travel, or attending a Conference or specialised training or for maintenance expenses of a patient going abroad for medical treatment or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/check-up.
- Release of exchange for meeting expenses for medical treatment abroad exceeding the estimate from the doctor in India or hospital/doctor abroad. [US$ 100,000]

FOREIGN EXCHANGE MANAGEMENT (CURRENT ACCOUNT TRANSACTIONS) RULES, 2000

- Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or 5% of the inward remittance whichever is more.
- Remittance exceeding [US $ 1 million] per project, for any consultancy service procured from outside India.
- Remittance exceeding US $ 1,00,000, by an entity in India by way of reimbursement of pre-incorporation expenses.

FOREX FACILITIES TO RESIDENTS

FOREX FACILITIES TO RESIDENTS

- In terms of Section 5 of the FEMA, persons resident in India are free to buy or sell foreign exchange for any current account transaction except for those transactions for which drawal of foreign exchange has been prohibited by Central Government, such as remittance out of lottery winnings, remittance of income from racing/riding, etc., or any other hobby, remittance for purchase of lottery tickets, banned magazines, football pools, sweepstakes, etc.,

FOREIGN CURRENCY DENOMINATED ACCOUNTS

- Persons resident in India are permitted to maintain foreign currency accounts in India under the following three Schemes:

Exchange Earners Foreign Currency Accounts

Resident Foreign Currency Accounts

Resident Foreign Currency (Domestic) Account

FOREIGN CURRENCY DENOMINATED ACCOUNTS

- **Exchange Earners Foreign Currency Accounts**

  Funds held in EEFC account can be utilised for all permissible current account transactions and also for approved capital account transactions as specified by the extant Rules/Regulations/ Notifications/ Directives issued by the Government/RBI from time to time. The account is maintained in the form of a **non-interest bearing current account.**

FOREIGN CURRENCY DENOMINATED ACCOUNTS

- **Resident Foreign Currency Accounts**

A Resident Foreign Currency (RFC) Account is an account to keep their foreign currency assets which were held outside India at the time of return can be credited to such accounts. RFC account can be maintained in the form of **current or savings or term deposit accounts**. The funds in RFC account are **free from all restrictions** regarding utilisation of foreign currency balances including any restriction on investment outside India.

FOREIGN CURRENCY DENOMINATED ACCOUNTS

- **Resident Foreign Currency (Domestic) Account**

  A Resident Foreign Currency (Domestic) Account, out of foreign exchange acquired in the form of currency notes, Bank notes and travellers' cheques, from any of the sources like, payment for services rendered abroad, as honorarium, gift, services rendered or in settlement of any lawful obligation from any person not resident in India. The account shall be maintained in the form of **Current Account and shall not bear any interest**. There is no ceiling on the balances in the account. The account may be debited for payments made towards permissible current and capital account transactions.

LIBERALISED REMITTANCE SCHEME TO RESIDENTS

LIBERALISED REMITTANCE SCHEME

- Master Circular on miscellaneous remittances from India – Facilities for Residents: contain provisions as to Liberalised Remittance Scheme.
- Under the Liberalised Remittance Scheme, all resident individuals, including minors, are allowed to freely remit up to USD 200,000 per financial year (April – March) for any permissible current or capital account transaction or a combination of both.
- Under the Scheme, resident individuals can acquire and hold immovable property or shares or debt instruments or any other assets outside India, without prior approval of the RBI. Individuals can also open, maintain and hold foreign currency accounts with banks outside India for carrying out transactions permitted under the Scheme.

LIBERALISED REMITTANCE SCHEME

- The remittance facility under the Scheme is not available for:
  - For any purpose specifically prohibited under Schedule-I (like purchase of lottery tickets/sweep stakes, proscribed magazines, etc.) or any item restricted under Schedule II of Foreign Exchange Management (Current Account Transactions) Rules, 2000;
  - For margins or margin calls to overseas exchanges / overseas counterparty;
  - For purchase of FCCBs issued by Indian companies in the overseas secondary market;

LIBERALISED REMITTANCE SCHEME

- For trading in foreign exchange abroad;
- For setting up a company abroad;
- Remittances directly or indirectly to Bhutan, Nepal, Mauritius and Pakistan;
- Remittances directly or indirectly to countries identified by the Financial Action Task Force (FATF) as "non co-operative countries and territories", from time to time;
- Remittances directly or indirectly to those individuals and entities identified as posing significant risk of committing acts of terrorism as advised separately by the RBI to the banks.

LIBERALISED REMITTANCE SCHEME

- **Requirements to be complied with by the remitter**
  - The individual will have to designate a branch of an AD through which all the remittances under the Scheme will be made.
  - The applicants should have maintained the bank account with the bank for a minimum period of 1 year prior to the remittance.
  - If the applicant seeking to make the remittance is a new customer of the bank, Authorised Dealers should carry out due diligence on the opening, operation and maintenance of the account.

LIBERALISED REMITTANCE SCHEME

- The AD should obtain bank statement for the previous year from the applicant to satisfy themselves regarding the source of funds. If such a bank statement is not available, copies of the latest Income Tax Assessment Order or Return filed by the applicant may be obtained.
- He has to furnish an application-cum-declaration in the specified format regarding the purpose of the remittance and declare that the funds belong to him and will not be used for the purposes prohibited or regulated under the Scheme.

CAPITAL ACCOUNT TRANSACTIONS

- Regulations have been notified by RBI, in consultation with Government of India, under FEMA for capital account transactions.

- Regulations specify the following:
  - Types of permissible capital account transactions
  - Simplified procedures for undertaking transactions.
  - The returns that have to be submitted to the Reserve Bank.

- Substantial powers have been granted to the Authorised Dealer Category – I banks to undertake capital account transactions on behalf of their clients.

PERMISSIBLE CAPITAL ACCOUNT TRANSACTIONS

- Permissible transactions of a **person resident in India** (as listed down under **Schedule I** to Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 as amended from time to time) :
  - Investment by a person resident in India in foreign securities;
  - Foreign currency loans raised in India and abroad by a person resident in India;
  - Transfer of immovable property outside India by a person resident in India;

PERMISSIBLE CAPITAL ACCOUNT TRANSACTIONS

- Guarantees issued by a person resident in India in favour of a person resident outside India;
- Export, import and holding of currency/currency notes;
- Loans and overdrafts (borrowings) by a person resident in India from a person resident outside India;
- Maintenance of foreign currency accounts in India and outside India by a person resident in India;
- Taking out of insurance policy by a person resident in India from an insurance company outside India;

PERMISSIBLE CAPITAL ACCOUNT TRANSACTIONS

  - Loans and overdrafts by a person resident in India to a person resident outside India;
  - Remittance outside India of capital assets of a person resident in India;
  - Sale and purchase of foreign exchange derivatives in India and abroad and commodity derivatives abroad by a person resident in India.
- A resident individual may draw from an authorized person, foreign exchange not exceeding USD 200,000 per calendar year for a capital account transaction specified in Schedule I.

PERMISSIBLE CAPITAL ACCOUNT TRANSACTIONS

- Where the drawal of foreign exchange by a resident individual for any capital account transaction specified in Schedule I exceeds USD 200,000 per calendar year, the limit specified in the regulations relevant to the transaction shall apply with respect to the drawal.

PERMISSIBLE CAPITAL ACCOUNT TRANSACTIONS

- Permissible transactions of a **person resident outside India** [as listed down under **Schedule II** to Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 as amended from time to time] :
- Investment in India by a person resident outside India, that is to say:
  - Issue of security by a body corporate or an entity in India and investment therein by a person resident outside India; and
  - Investment by way of contribution by a person resident outside India to the capital of a firm or a proprietorship concern or an association of persons in India.

PERMISSIBLE CAPITAL ACCOUNT TRANSACTIONS

- Acquisition and transfer of immovable property in India by a person resident outside India.
- Guarantee by a person resident outside India in favour of, or on behalf of, a person resident in India.
- Import and export of currency/currency notes into/from India by a person resident outside India.
- Deposits between a person resident in India and a person resident outside India.
- Foreign currency accounts in India of a person resident outside India.
- Remittance outside India of capital assets in India of a person resident outside India.

FOREIGN INVESTMENTS IN INDIA

CLASSIFICATION OF FOREIGN INVESTMENTS

Equity

- Foreign Direct Investment
- Foreign Portfolio Investment
- Foreign Venture Capital Investment

Debt

- External Commercial Borrowings

FOREIGN DIRECT INVESTMENT (FDI)

- A foreign company planning to set up business operations in India may:
  - Incorporate a company under the Companies Act, 1956, as a Joint Venture or a Wholly Owned Subsidiary.
  - Set up a Liaison Office / Representative Office or a Project Office or a Branch Office of the foreign company which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000.

FOREIGN DIRECT INVESTMENT (FDI)

- An Indian company may receive Foreign Direct Investment under the two routes as given under :

AUTOMATIC ROUTE

- FDI up to 100 per cent is allowed in all activities/sectors except under certain situations.
- FDI in sectors /activities to the extent permitted under the automatic route does not require any prior approval either of the Government or the Reserve Bank of India.

GOVERNMENT ROUTE

- FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance.

FOREIGN DIRECT INVESTMENT (FDI)

- FDI is prohibited under the Government Route as well as the Automatic Route in the following sectors:

  - Retail Trading (except single brand product retailing)
  - Atomic Energy
  - Lottery Business, Gambling and Betting
  - Business of Chit Fund and Nidhi Company

FOREIGN DIRECT INVESTMENT (FDI)

- Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations)
- Housing and Real Estate business (except development of townships, construction of residential/commercial premises, roads or bridges
- Trading in Transferable Development Rights (TDRs)

FOREIGN DIRECT INVESTMENT (FDI)

- In single brand product retail trading, FDI up to 51% was permitted, subject to conditions specified under the Consolidated FDI Policy.

- *However, the Government of India reviewed the extant policy on FDI and decided that FDI, up to100%, under the government approval route, would be permitted in Single-Brand Product Retail Trading, subject to specified conditions, vide Press Note 1 of 2012 issued by Department of Industrial Policy and Promotion.*

ISSUE OF ADRS/ GDRS BY INDIAN COMPANIES

- Indian companies can raise foreign currency resources abroad through the issue of ADRs/ GDRs, in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India thereunder from time to time.

- A company can issue ADRs / GDRs, if it is eligible to issue shares to persons resident outside India under the FDI Scheme.

ISSUE OF ADRS/ GDRS BY INDIAN COMPANIES

- There are no end-use restrictions on GDR/ADR issue proceeds, except for an express ban on investment in real estate and stock markets.
- Foreign investment through preference shares is treated as foreign direct investment. However, the preference shares should be fully and mandatorily convertible into equity shares within a specified time to be reckoned as part of share capital under FDI.
- Debentures which are fully and mandatorily convertible into equity within a specified time would be reckoned as part of equity under the FDI Policy.

FOREIGN PORTFOLIO INVESTMENT

- The Reserve Bank of India has granted general permission to SEBI Registered Foreign Institutional Investors (FIIs) to invest in India under the Portfolio Investment Scheme (PIS).

- FIIs include Asset Management Companies, Pension Funds, Mutual Funds, Investment Trusts as Nominee Companies, Incorporated / Institutional Portfolio Managers or their Power of Attorney holders, University Funds, Endowment Foundations, Charitable Trusts and Charitable Societies.

FOREIGN PORTFOLIO INVESTMENT

- Non- Resident Indian (NRIs) and Persons of Indian Origin (PIOs) can purchase or sell shares/ fully and mandatorily convertible debentures of Indian companies on the Stock Exchanges under the Portfolio Investment Scheme.

- *Qualified Institutional Investors (QFIs) are persons non-resident in India but resident in a country that is compliant with Financial Action Task Force (FATF) standards and that*

FOREIGN PORTFOLIO INVESTMENT

is a signatory to International Organization of Securities Commission's (IOSCO‟s) Multilateral Memorandum of Understanding (MMOU).

- *QFIs have been granted general permission for investment under Portfolio Investment Scheme (PIS) route similar to FIIs,* vide RBI‟s Circular RBI/2011-12/347 A. P. (DIR Series) Circular No.66 dated January 13, 2012 .

MODES OF ACCESSING DEBT FUNDS FROM ABROAD BY INDIAN COMPANIES

At present, Indian companies can access funds from abroad in these ways–

- External Commercial Borrowings (ECB)
- Foreign Currency Convertible Bonds (FCCBs)
- Preference shares (i.e. non-convertible, optionally convertible or partially convertible)
- Foreign Currency Exchangeable Bond (FCEB)

ECBs DEFINED

External Commercial Borrowings ("ECB") refer to commercial loans in the form of:

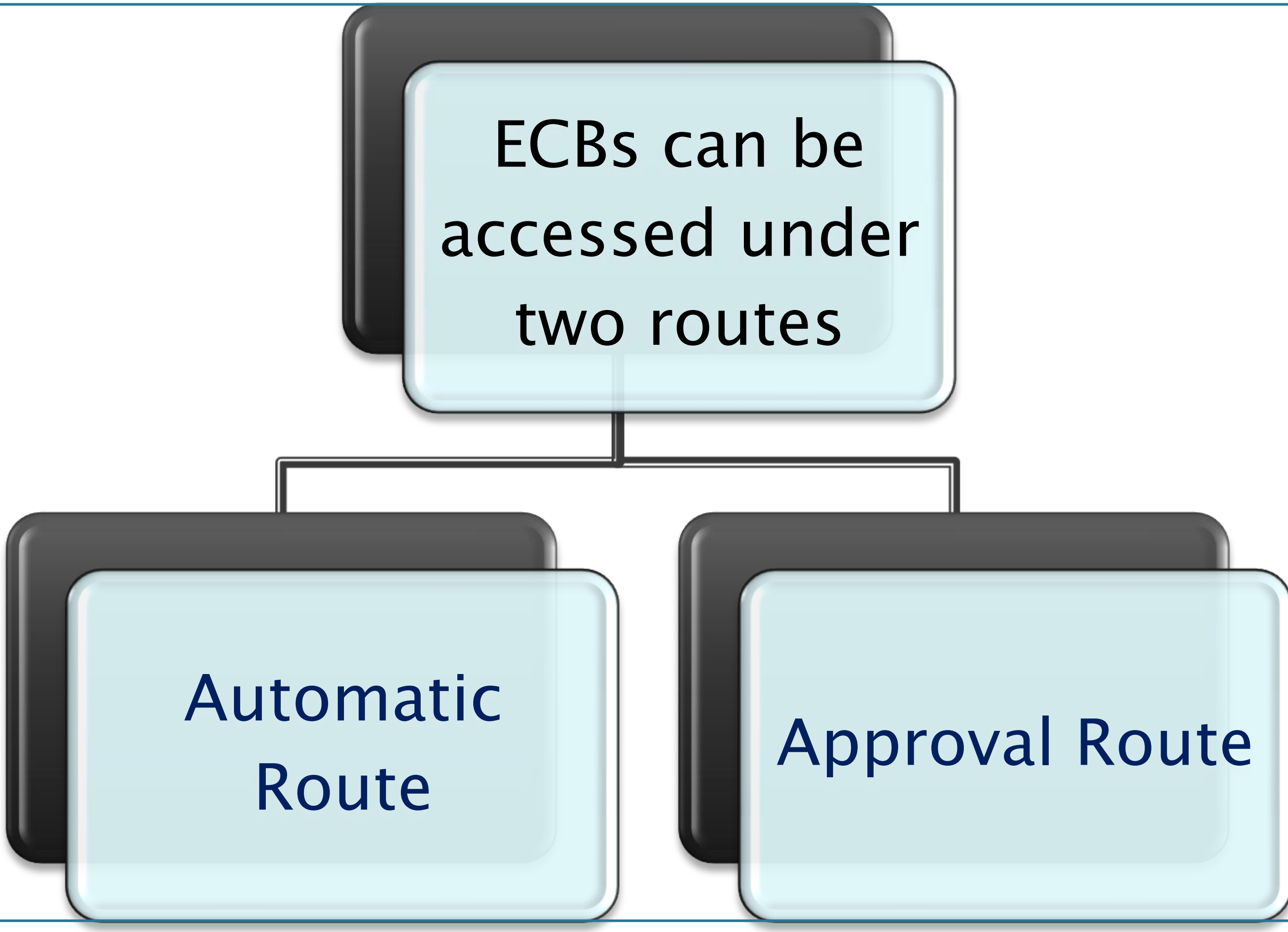
- bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares)
- availed of from non-resident lenders with a minimum average maturity of 3 years.

ECBs with a minimum maturity of 3 years

Includes: optionally convertible debentures, non convertible bonds, FCCBs, FCEBs, securitized instruments, financial leases

Excludes: trade credit – supplier and buyers' credit compulsorily convertible debentures, compulsorily convertible preference shares, equity investments

EXTERNAL COMMERCIAL BORROWINGS



EXTERNAL COMMERCIAL BORROWINGS

- Automatic Route

  ECB for investment in real sector–industrial sector, infrastructure sector–in India, and specified service sectors are under Automatic Route, i.e. do not require RBI/ Government of India approval.

EXTERNAL COMMERCIAL BORROWINGS

- Approval Route
  - All investments other than those covered under Automatic Route come under the purview of Approval Route.
  - In case of doubt as regards eligibility to access the Automatic Route, applicants may take recourse to the Approval Route.

EXTERNAL COMMERCIAL BORROWINGS

- Restrictions on end-uses of ECBs
  - For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate [investment in Special Purpose Vehicles (SPVs), Money Market Mutual Funds (MMMFs), etc., are also considered as investment in capital markets).
  - For real estate sector.
  - For working capital, general corporate purpose and repayment of existing Rupee loans.

OTHER DEBT FUNDS

- The ECB policy is applicable to FCCBs
- Foreign Currency Convertible Bonds (FCCBs) mean a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency.
- The bonds are required to be issued in accordance with the scheme viz., "Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993”

OTHER DEBT FUNDS

- Preference shares (i.e. non-convertible, optionally convertible or partially convertible) for issue of which, funds have been received on or after May 1, 2007 would be considered as debt and should confirm to the ECB policy.

- The guidelines, rules, etc governing ECBs are also applicable to FCEBs.

- Foreign Currency Exchangeable Bond (FCEB) means a bond expressed in foreign currency, the principal and interest in respect of which is payable in

OTHER DEBT FUNDS

foreign currency, issued by an Indian Company and subscribed to by a person who is a resident outside India, in foreign currency and exchangeable into equity share of another company, to be called the Offered Company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments.

- The FCEB must comply with the "Issue of Foreign Currency Exchangeable Bonds (FCEB) Scheme, 2008

OVERSEAS INVESTMENT BY INDIAN ENTITIES

OVERSEAS INVESTMENT BY INDIAN ENTITIES

- It is the reverse of Foreign Direct Investment (FDI) i.e. Indian direct investment abroad.
- Direct investments by residents in Joint Venture (JV) and Wholly Owned Subsidiary (WOS) abroad are being allowed, in terms of clause (a) of sub-section (3) of section 6 of the Foreign Exchange Management Act 1999.
- Direct investment outside India means investments, either under the Automatic Route or the Approval Route, by way of contribution to the capital or subscription to the Memorandum of Association of a foreign entity, signifying a long-term interest (setting up a Joint Venture (JV) or a Wholly Owned Subsidiary (WOS)) in the overseas entity.

OVERSEAS INVESTMENT BY INDIAN ENTITIES

Automatic Route

- Indian Party does not require any prior approval from the Reserve Bank for setting up a JV/WOS abroad. (However, in case of investment in the **financial services sector**, prior approval is required from the regulatory authority concerned both in India and abroad).

Approval route

- Proposals not covered by the conditions under the automatic route require the prior approval of the Reserve Bank for which a specific application in form ODI with the documents prescribed therein is required to be made through the Authorized Dealer Category – I banks.

OVERSEAS INVESTMENT BY INDIAN ENTITIES

- **Real estate and banking business are the prohibited sectors for overseas direct investment.**

- However, Indian banks operating in India can set up JVs/WOSs abroad provided they obtain clearance under the Banking Regulation Act, 1949, from regulatory authorities.

OVERSEAS INVESTMENT BY INDIAN ENTITIES

- Funding for overseas direct investment can be made by one or more of the following sources:
  - Drawal of foreign exchange from an AD bank in India.
  - Swap of shares (refers to the acquisition of the shares of an overseas entity by way of exchange of the shares of the Indian entity).
  - Capitalization of exports.
  - Through the proceeds of External Commercial Borrowings / Foreign Currency Convertible Bonds.

OVERSEAS INVESTMENT BY INDIAN ENTITIES

- In exchange of ADRs / GDRs issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and the guidelines issued by Government of India in the matter.
- Balances held in Exchange Earners Foreign Currency account of the Indian Party maintained with an Authorized Dealer.
- Proceeds of foreign currency funds raised through ADR / GDR issues.

FACILITIES FOR NON - RESIDENT INDIANS (NRIs) AND PERSONS OF INDIAN ORIGIN (PIOs)

DIFFERENT TYPES OF ACCOUNTS WHICH CAN BE MAINTAINED BY AN NRI/PIO IN INDIA

- RBI has issued a Master Circular on Remittance Facilities for Non-Resident Indians / Persons of Indian Origin / Foreign Nationals
- If a person is NRI or PIO, she/he can, without the permission from the Reserve Bank, open, hold and maintain the different types of accounts with an Authorised Dealer in India.

Non-Resident Ordinary Rupee Account (NRO Account)

Non-Resident (External) Rupee Account (NRE Account)

Foreign Currency Non Resident (Bank) Account – FCNR (B) Account

DIFFERENT TYPES OF ACCOUNTS WHICH CAN BE MAINTAINED BY AN NRI/PIO IN INDIA

- **Non-Resident Ordinary Rupee Account (NRO Account)**
  - NRO accounts may be opened / maintained in the form of **current, savings, recurring or fixed deposit** accounts.
  - Account should be denominated in Indian Rupees.
  - Eligible debits such as all local payments in rupees including payments for investments as specified by the Reserve Bank and remittance outside India of current income like rent, dividend, pension, interest, etc., net of applicable taxes, of the account holder.

DIFFERENT TYPES OF ACCOUNTS WHICH CAN BE MAINTAINED BY AN NRI/PIO IN INDIA

- **Non-Resident (External) Rupee Account (NRE Account)**
  - NRE account may be in the form of savings, current, recurring or fixed deposit accounts. Such accounts can be opened only by the non-resident himself and not through the holder of the power of attorney.
  - Account will be maintained in Indian Rupees.
  - Balances held in the NRE account are freely repatriable.
  - Eligible debits are local disbursements, transfer to other NRE/ FCNR accounts of person eligible to open such accounts, remittance outside India, investments in shares / securities/commercial paper of an Indian company, etc.

DIFFERENT TYPES OF ACCOUNTS WHICH CAN BE MAINTAINED BY AN NRI/PIO IN INDIA

- **Foreign Currency Non Resident (Bank) Account – FCNR (B) Account**
  - FCNR (B) accounts are only in the form of **term deposits of 1 to 5 years**.
  - Account can be in any **freely convertible currency**.
  - All debits / credits permissible in respect of NRE accounts, including credit of sale proceeds of FDI investments, are permissible in FCNR (B) accounts also.

FACILITIES TO FOREIGN NATIONALS AND FOREIGN TOURISTS

FACILITIES TO FOREIGN NATIONALS AND FOREIGN TOURISTS

- Foreign tourists during their short visit to India can open a Non-Resident (Ordinary) Rupee (NRO) account (Current / Savings) with any Authorised Dealer bank dealing in foreign exchange. Such account can be opened up to a maximum period of 6 months.

- Funds remitted from outside India through banking channel or those obtained by sale of foreign exchange brought by the tourists to India can be credited to the NRO account.

FACILITIES TO FOREIGN NATIONALS AND FOREIGN TOURISTS

- Authorised Dealer banks have been allowed to convert the balance in the account for payment to the account holder at the time of departure from India into foreign currency, provided the account has been maintained for a period not exceeding six months and the account has not been credited with any local funds, other than interest accrued thereon.

THANK YOU